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Statement by Mr. Echavarría
Colombia

On behalf of
Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Spain,
República Boliviariana de Venezuela

STATEMENT BY MR. JUAN JOSÉ ECHAVARRÍA, GOVERNOR OF BANCO DE LA REPÚBLICA (CENTRAL BANK OF COLOMBIA)

On behalf of Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, The Bolivarian Republic of Venezuela, and Spain

International Monetary and Financial Committee
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Global Economic Outlook

The current global economic environment is particularly challenging since short-term perspectives underscore the need for adjustments to the global economy in the medium-term. On the one hand, global economic activity continues to improve, boosted by higher investment, industrial production and growth of international trade. According to IMF's data, the world economy grew faster in 2017 than official WEO projections in October 2017. On the other, global growth is projected to soften in the mid-term, with risks beyond several quarters biased to the downside because of the possibility of a sharp tightening in financial conditions and a step back in the process of economic integration.

Along the same lines, we have seen a significant increase in volatility in bond and equity markets coexisting with a buoyant economic sentiment, despite tighter labor markets and a slow rise of headline inflation in advanced economies. Financial conditions are still accommodative, even after some advanced economies have begun normalizing their monetary policy. Although this appears to have dampened the near-term risk to growth, loose financial conditions risk fueling a buildup in financial vulnerabilities that may put the medium term at risk, as the latest update to the Global Financial Stability Report has rightly emphasized.

We continue to worry about the possibility that heightened financial imbalances, excessive risk-taking and mispricing of risks, may reduce medium-term growth. Furthermore, excessive debt accumulation and asset price misalignments, particularly when the accumulation of debt does not happen through the traditional banking sector, but rather through shadow banking, may contribute to the generation of financial imbalances.

EMDEs are especially vulnerable to these risks. They have been important recipients of capital inflows—which have helped adjust to external shocks—but have led to higher participation of foreign investors in local debt markets, which increased almost tenfold since 2007. But even if greater participation by foreigners in local markets fosters the development of capital markets, provides liquidity and expands the investor base, it generates challenges to macroeconomic and financial stability—particularly if there is a significant concentration of investors. There is evidence that the depth and composition of international investors in local financial markets could expand the impact of external shocks and that large institutional investors can react more strongly and persistently when facing economic shocks.

The risk scenario is further compounded by trade tensions and the risks associated to shifts towards protectionist policies which may have a direct effect on economic activity and confidence, creating a particularly challenging outlook for EMDE's. Negotiations like the North American Free Trade Agreement and Brexit, as well as unilateral hikes in import tariffs and the looming threat of trade wars can disrupt global supply chains, reduce productivity and investment, slow the spread of new technologies and innovation and, crucially, make cooperation and coordinated policy solutions more difficult.

These are challenges for which we need to prepare now. They require decisive and coordinated action, and need to be tackled now that cyclical conditions are favorable. The same goes for dealing with WEO's recent warnings on the challenges posed by ageing populations and low productivity.

Therefore, tackling increased protectionism and fostering international cooperation should be the priorities for our work. Notwithstanding the political and economic causes underlying these trends, they are of major concern for all countries and institutions, including the IMF. The recent US tariff announcement is a case in point that may set the world on a dangerous cycle of retaliatory measures with highly disruptive consequences.

We also think that greater attention should be given to the widening imbalances in the world economy and to the impact that uncoordinated and procyclical policies can have for all. High current account deficits and/or debt can place countries in difficult situations in the face of new downturns, be the source of more protectionism, and further erode the support for global integration and cooperation.

Economic Policy

Under the current circumstances, we must therefore take advantage of the window of opportunity to make significant progress in policies and reforms that boost productivity, increase potential output, and improve long-term economic perspectives. We need to look beyond the cyclical recovery to implement structural reforms that bring inclusive and sustainable growth. This is a good antidote for populism and inward-looking policies.

In this context, it is critical to ensure the Fund´s analytical toolkit be upgraded to better measure the impact of structural reforms on growth, employment and potential growth estimates, to strengthen surveillance and policy recommendations. This would support the improvement of policy quality and help bring about coordination.

We need to recognize that increasing economic resilience in a period of tightening financial conditions can be especially challenging. Economies should seek to maintain sound macro and financial policies that internalize cyclical positions and use policies in a countercyclical way. In fact, the effectiveness of a policy reaction to external shocks depends mainly on the availability of buffers and the capacity of economies to rebuild them.

Macroprudential policies should also be a fundamental part of the policy toolkit to deal with systemic risks. They increase the resilience of the financial sector and provide effective support in smoothing the negative consequences of financial cycles. The Fund should continue to play a critical role in this area, as well as in the early detection of problems, the implementation of sound policies and in ensuring internal consistency among them. Under the current circumstances the quality and consistency of policy will be a fundamental determinant for rebuilding trust and ensuring the current recovery can put the world economy in a path of greater stability and growth.